

Issues, Not Injuries: The Effects of Covenants Not to Sue on Small Competitors

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The Supreme Court recently held in *Already, LLC v. Nike, Inc.*,¹ that a trademark infringement case and a counterclaim alleging the trademark's invalidity can be dismissed for mootness when a plaintiff unilaterally issues a covenant not to sue to the defendant. Such covenants enable large companies to zealously enforce trademarks without risking their intellectual property portfolios and may adversely affect smaller competitors in future cases.

Already LLC v. Nike, Inc. began when Nike, the colossal shoe manufacturer, aggressively enforced the trademark for its Air Force 1 shoes. Nike issued cease and desist letters and initiated lawsuits against competitors allegedly infringing its Air Force 1 trademark.² Many rivals complied with the letters or settled the lawsuits, prompting the removal of competing products from the marketplace.³ Already, a smaller footwear competitor, refused to stop selling its shoes; thus Nike sued.⁴ Nike's lawsuit provided Already standing and it counterclaimed, alleging Nike's trademark to be invalid.⁵ Four months later, Nike unilaterally issued a covenant not to sue because the alleged infringement did not "warrant the substantial time and expense of continued litigation."⁶ The covenant prevented Nike from making claims against any of Already's existing products or "colorable imitations" of its products.⁷ Nike satisfied its "formidable burden" under the voluntary cessation test and the case became moot because Nike could not "reasonably be expected" to resume any trademark action against Already.⁸ The covenant was sufficiently broad—the Court could not identify a shoe that Already had or would make that is not

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¹ 133 S. Ct. 721 (2013).

² Brief for Petitioner at 35, *Already, LLC v. Nike, Inc.*, 133 S. Ct. 721 (2013) (No. 11-982).

³ *Id.*

⁴ *Already, LLC v. Nike, Inc.*, 133 S. Ct. 721, 725 (2013).

⁵ *Id.* at 725, 727.

⁶ *Id.* at 725 (internal quotation marks omitted). The covenant is not a contract. Rather, the issuing party is bound to the covenant's terms by judicial estoppel. Transcript of Oral Argument at 49, *Already*, 133 S. Ct. 721 (No. 11-982) [hereinafter Transcript].

⁷ *Already*, 133 S. Ct. at 725.

⁸ *Id.* at 727. The voluntary cessation test examines whether the "allegedly wrongful behavior [could] reasonably be expected to recur." *Id.* This is a "formidable burden" that must be shown because otherwise a party could engage in unlawful conduct, stop when sued, declare the case moot, and then resume the conduct. *Id.*

protected by the covenant.⁹ The entire case, including the counterclaim attacking the validity of Nike's trademark, was dismissed after Already was unable to assert an Article III injury to establish standing.¹⁰ The covenant prevented adjudication of the Air Force 1 trademark's validity, helping to protect the popular Nike product.¹¹

Caution is needed in future cases dealing with covenants not to sue because these covenants can adversely affect smaller competitors. Justice Kennedy's concurrence, joined by Justices Thomas, Alito, and Sotomayor, recognizes some of the issues these covenants present and "underscore[s] that [they are not] an automatic means for" parties like Nike to escape adverse adjudication.¹² Few cases have analyzed the effects of covenants not to sue on ongoing litigation and "careful consideration" is required when a party uses a covenant to moot a case.¹³ Covenants like Nike's disadvantage smaller competitors in litigation and disrupt rival businesses—they jeopardize relationships with investors and partners, force businesses to reveal future plans, and make companies more tentative in future product designs.

Covenants not to sue ironically encourage lawsuits. They allow trademarks to be used as a litigious weapon against smaller competitors without much risk to the intellectual property. The trademark holder can allege infringement against competitors to obtain a favorable settlement or adjudication. In the rare case the competitor resists and alleges the trademark is invalid,¹⁴ the trademark holder can avoid potentially adverse judgment by unilaterally issuing a covenant, turning the alleged infringer into an involuntary licensee.¹⁵ A smaller company is forced to expend valuable resources on litigation, and is unable to

⁹ *Id.* at 728 ("The covenant is unconditional and irrevocable. Beyond simply prohibiting Nike from filing suit, it prohibits Nike from making any claim *or* any demand. It reaches beyond Already to protect Already's distributors and customers. And it covers not just current or previous designs, but any colorable imitations."). The covenant does not protect, however, exact copies of Air Force 1s. *Id.* at 728 n.*.

¹⁰ *Already*, 133 S. Ct. at 729–30.

¹¹ The Air Force 1 is a popular Nike shoe that has been in production since 1982 and is one of Nike's best-selling shoe designs. Respondent's Brief in Opposition at 3, *Already*, 133 S. Ct. 721 (No. 11-982). The shoe has been produced in more than 1,700 color combinations and millions of Air Force 1s are sold annually. Nike, Inc. v. Already, LLC, No. 09 Civ. 6366(RJS), 2011 WL 310321, at *1 (S.D.N.Y. Jan. 20, 2011). Nike candidly acknowledged the purpose of delivering the covenant was to divest the court of subject matter jurisdiction. Brief for Petitioner, *supra* note 2, at 15.

¹² *Already*, 133 S. Ct. at 733 (Kennedy, J., concurring).

¹³ *Id.* at 734.

¹⁴ Nike asserted it had "cleared out the worst offending infringers," leaving Already as one of the last companies identified on Nike's top ten list of infringers. *Id.*

¹⁵ See *id.* at 731 (majority opinion); Transcript, *supra* note 6, at 10 (noting that Already preferred to not be "the involuntary licensee of the [company] that sued it"). By contrast, companies like Already may need to make counterfeit products that copy the trademark exactly to have Article III standing to invalidate a competitor's trademark. Transcript, *supra* note 6, at 34–35, 39, 54. This, however, will likely be beyond the covenant not to sue and exposes smaller competitors to legal liability. See, e.g., *Already*, 133 S. Ct. at 728 n.*.

challenge its larger competitor's trademark. Moreover, even though a trademark holder may not prevail in litigation, its covenant can reassert the allegation that the competitor's product infringes the trademark.¹⁶ Thus, the competitor's reputation is adversely affected in addition to devoting resources to legal counsel.

Covenants also create practical advantages in litigation for large companies that sue smaller competitors for infringement. A covenant provides the trademark holder additional time to monitor a competitor's business to determine if a trial is worthwhile. If an alleged infringer's products are not performing well and decides to fight back, the trademark holder may decide that the cost of litigation is no longer warranted.¹⁷ If a trial is expedient, the covenant is useful because it allows an escape from litigation. This provides the trademark holder the time and opportunity to examine the strength of its allegations. For example, Nike abandoned litigation after eight months, in the middle of discovery, and after some skeptical comments by the district court judge regarding the alleged infringement.¹⁸ In future cases, a trademark holder may use covenants as a means to protect itself if the smaller competitor is unwilling to settle and the litigation's outcome does not look favorable.

Moreover, covenants can disrupt business relations between a manufacturer and its distributors, retailers, and investors.¹⁹ Already presented affidavits from potential investors alleging Nike's actions prompted them to not invest in the company.²⁰ Pending litigation represents additional risk and may dissuade investment in or partnerships with smaller companies.²¹ Even if a covenant is issued, its scope may not be broad enough to provide adequate certainty.²² Thus, covenants make it more difficult for smaller companies to raise additional capital while they are simultaneously forced to divert important resources away from innovation to legal counsel.

¹⁶ Transcript, *supra* note 6, at 11–12. Nike's covenant continued to allege infringement. The covenant was issued merely because Already did not infringe "at a level sufficient to warrant the substantial time and expense of continued litigation." Brief for Petitioner, *supra* note 2, at 15.

¹⁷ Brief for Petitioner, *supra* note 2, at 15; *see also* *Already*, 133 S. Ct. at 725 (reporting that Nike's covenant stated Already's actions no longer warranted the expense of litigation).

¹⁸ Brief for Petitioner, *supra* note 2, at 14; *see also* *Already*, 133 S. Ct. at 725.

¹⁹ *See Already*, 133 S. Ct. at 733–34 (Kennedy, J., concurring). Justice Kennedy would require the trademark holder to fulfill its "formidable burden" by showing the competitor's business is not weakened by litigating the issue of mootness. *Id.* at 734.

²⁰ *Id.* at 730 (majority opinion). As part of Nike's aggressive enforcement of its trademark, Already also alleged that Nike threatened retailers with cancelling its account or delaying shipments if retailers continued to sell Already's products. *Id.*

²¹ *Id.* at 734 (Kennedy, J., concurring) ("The mere pendency of litigation can mean that other actors in the marketplace may be reluctant to have future dealings with the alleged infringer."); Brief for Petitioner, *supra* note 2, at 21.

²² Reply Brief for Petitioner at 2, *Already*, 133 S. Ct. 721 (2013) (No. 11-982) [hereinafter Reply Brief].

Covenants can also force smaller companies to reveal future business plans.²³

After the trademark holder demonstrates that the covenant protects against all allegedly unlawful conduct, the alleged infringer must show its products will not be covered by the covenant if it wishes to continue litigating the trademark's validity.²⁴ A general intent to produce products is insufficient; rather, a company must assert sufficiently concrete plans for the Court to determine if the covenant provides adequate protection.²⁵ This gives companies like Nike the advantage of access to a competitor's future business projects.²⁶

Further, smaller companies may struggle to innovate because of a fear of future litigation. *Already* described itself as "once bitten, twice shy."²⁷ A party that has been sued worries of potential future suits and struggles to resume its business.²⁸ This may cause smaller competitors to be overly cautious, designing around alleged trademarks and incurring costs to determine if new products are legally protected.²⁹

While these policy implications do not rise to a level of injury to satisfy Article III standing, the issues raised in *Already* may impact smaller competitors.³⁰ As Justice Kennedy notes, a lawsuit that the trademark holder initiated and later seeks to declare moot can still be costly and disrupt the

²³ See *Already*, 133 S. Ct. at 734 (Kennedy, J., concurring).

²⁴ *Id.* at 728 (majority opinion). Chief Justice Roberts stated, "The case is moot if the court, considering the covenant's language and the plaintiff's anticipated future activities, is satisfied that it is 'absolutely clear' that the allegedly unlawful activity cannot reasonably be expected to recur." *Id.* at 729.

²⁵ *Id.* at 728; see also Transcript, *supra* note 6, at 6–8, 23–24. The Court reasoned, "Given the covenant's broad language, and given that *Already* has asserted no concrete plans to engage in conduct not covered by the covenant, we can conclude the case is moot because the challenged conduct cannot reasonably be expected to recur." *Already*, 133 S. Ct. at 729.

²⁶ Transcript, *supra* note 6, at 27; see also *Already*, 133 S. Ct. at 734 (Kennedy, J., concurring).

²⁷ *Already*, 133 S. Ct. at 731 (majority opinion).

²⁸ Reply Brief, *supra* note 22, at 13–14; Transcript, *supra* note 6, at 50. Chief Justice Roberts was not sympathetic to this argument, noting, "there is no reason for *Already* to be so shy" since the covenant prevents Nike from suing again. *Already*, 133 S. Ct. at 730–31. One such fear, however, may be that competitors other than Nike may bring similar suits.

²⁹ Reply Brief, *supra* note 22, at 13–14; see also Transcript, *supra* note 6, at 8–9.

³⁰ There are some constraints on the overuse of covenants not to sue. For example, firms that hand out these covenants weaken their trademarks and overly licensed trademarks may be invalidated. *Already*, 133 S. Ct. at 731; Transcript, *supra* note 6, at 40, 48. Nike's counsel similarly argued that the covenant does not impose drastic inequity. See, e.g., Transcript, *supra* note 6, at 32, 51 (noting protective orders can enable only appropriate parties to see confidential information, thus mitigating the concern of the competitor having to share its future business plans). This comment does not adjudge whether countervailing forces offset the issues that harm *Already* and companies similarly situated. Rather, it highlights some important issues that may affect smaller competitors if trademark holders continue to employ covenants not to sue in a manner similar to Nike.

competitor.³¹ As larger companies employ covenants not to sue while aggressively enforcing their intellectual property portfolios, it is imperative courts “proceed with caution” before holding that these covenants terminate litigation.³²

³¹ *Already*, 133 S. Ct. at 734 (Kennedy, J., concurring).

³² *Id.*